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SUBJECT: Insurance Capital Munich - Industry Experiences Delayed
Crisis, Rethinks D and O Coverage

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SUMMARY

¶1. (SBU) Germany's primary insurance firms experienced the economic crisis with a delay. Profits from classic insurance business and international investments are decreasing, and high sums have been paid out after insured businesses have gone bankrupt. Layoffs seem inevitable, as the life insurance business in particular is in the red. On the positive side, German insurance companies were on the whole not overly exposed to the collapse in the credit default business. Notably, insurance companies saved significant amounts of money after negotiating lower payouts on their liabilities arising from the Siemens bribery scandal. The Siemens settlement could become a precedent for changing how insurance policies are written for firms and their managers, with both assuming greater liability for their mistakes. End Summary

Sour Investments Pressure Major Insurance Carriers
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¶2. (SBU) Allianz and Munich Re, Germany's major insurance firms, based in Munich, are experiencing serious downturns in some sectors one year after the outbreak of the financial crisis. In several recent conversations, Consulate contacts pointed to three problem areas. First, the life insurance sector was the most exposed. Insurers invested hundreds of billions of Euros earned from life insurance premiums or similar products in the equity market. "The profit margins of these investments during the recent slump melted away and hardly cover the fixed interest rates for life insurance," a market strategy manager of Munich Re said. Second, the classic insurance business has become more difficult, since clients have become increasingly thrifty. Third, the increasing number of business insolvencies has led to higher payouts on so-called guarantee insurance contracts.

¶3. (SBU) The industry anticipates a difficult 2010, with a negative impact on employment. Allianz has laid off 4,700 employees since the beginning of the crisis. Munich Re's subsidiary "Ergo" reportedly plans to eliminate 1,800 jobs by the end of 2010 and will need new capital infusions from its parent, but no government bailout, our contact assured us. Although Munich Re recently announced a 2009 profit of 2.5 billion Euros, in part thanks to the absence of major hurricanes in the U.S., they expect much of this money will go to cover subsidiaries' anticipated losses.

Cutting D and O Losses: The Siemens Case

¶4. (SBU) Our contact at Munich Re told us that the background hum in the directors and officers (D&O) business had gotten louder in recent months as insurers adopt a stricter view on the personal liability of senior managers for costly business errors, like

bribery or faulty financial products. The limit of liability for a single manager under most policies does not exceed 250 million Euros, but considering how many managers may become involved in a company's crisis, this could still cause insurers serious problems. For example, Siemens and a group of insurers led by Allianz recently agreed on reduced payments on liability policies that kicked in after the bribery scandal had already cost Siemens over two billion euros in fines. The parties settled for a payment of 100 million euros by the insurers, instead of the 250 million euros initially claimed by Siemens. Now, Siemens is trying to recoup some of its losses from the responsible former managers, who believed their D and O insurance protected them absolutely. The case is being interpreted as symptomatic of a changing view on managers' personal liability. Turning to the banking sector, the Munich Re D and O expert told us, "Unlike the Siemens corruption case, most cases in the banking sector are not quite as clear. Insurers are now concerned about a possible wave of sentences against managers." He added that in the Siemens case, Munich Re had hoped Allianz would withstand the pressure and not pay anything at all.

COMMENT

¶5. (SBU) Munich Re and Allianz boasted in the past that their "core businesses were risky enough" so they "stuck to staid investments" and "avoided racy things like credit default swaps." This approach had "earned them the mockery of their peers in the past but now made them look like brilliant and profitable managers." Today, they are taking this conservative approach one step further by looking harder at directors' and officers' insurance policies. The question is, how big a mistake can directors and officers make before they risk losing their liability insurance? The Siemens settlement could point the way to a major re-think of insurance as banking sector problems deepen worldwide. In the future, managers and their companies may not be able to avoid responsibility just by signing an insurance

policy in Germany.

Tribble